SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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The Grass Is Always Greener

U.S. Activity In Foreign Securities

Given the onset of the Mideast crisis August 2, one might have thought, based on historical experience, that the U.S. investor would retreat homeward, perhaps by selling off foreign equities and buying U.S. bonds; the traditional "safe haven" approach. Instead, U.S. investors made additional net purchases of foreign equities in 3Q90 of $810 million. While certainly a modest figure, we believe the 3Q90 pattern indicates that U.S. investors have faith in foreign equity markets despite the precariousness of the world's political and economic situation. Year-to-date acquisitions of foreign equities is now at $7.3 billion. This amount is below last year's pace but still good enough, by far, for the second highest level ever.

U.S. Net Purchases of Foreign Financial Assets
($Bils.)

	I-III 90	*I-III 89*
Equities	$ 7.3	$ 9.4
Debt	15.6	5.3
Direct Investment	33.0	27.7
Total	$55.9	$42.4

Interestingly, in the month of August, U.S. investors made net purchases of $90 million of foreign equities. In sharp contrast, SIA's *Investor Activity Report* indicates that institutional investors were actually net sellers of U.S. equities totalling $1.8 billion in August. Given the different sources of data, we do not believe a perfect direct comparison is appropriate; however, the trend is indicative of the U.S. investor's serious commitment to portfolio diversification.

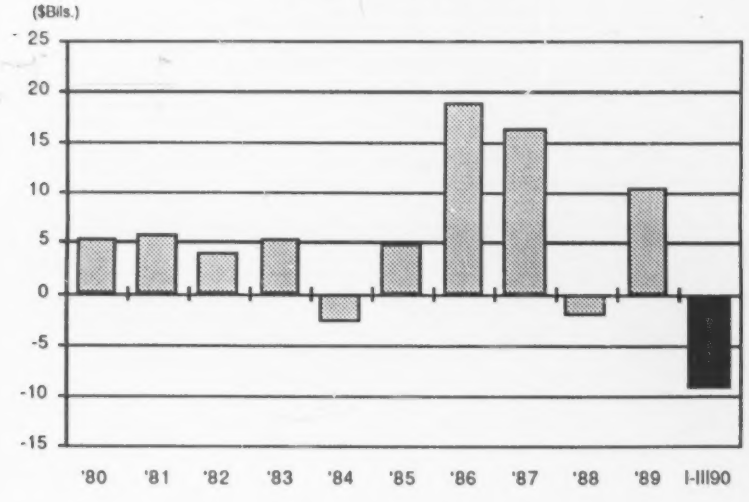
On the fixed-income side, U.S. investors nibbled at foreign bonds in 3Q90, making net purchases of about $665 million. Although off the pace of the previous quarters, the total for the year is now $15.6 billion, double any earlier year. In comparison, institutional net purchases of U.S. corporate bonds through the first half 1990 are, on an annualized basis, down 25% from the prior year. We further note that the U.S. investors' preference for foreign bonds in 1990 relative to foreign equities is the mirror image of their posture in 1989 and consistent with the current high interest/rate lower equity price environment.

As we've explained before, we continue to believe that the higher yields on foreign bonds, combined with strong foreign currencies and a weak dollar, have made foreign fixed-income instruments attractive. Also, given the recent downgradings/defaults on U.S. corporate bonds (defaults on corporate debt payments will reach a 20-year high in 1990) U.S. investors may be viewing foreign bonds as a "substitute" instrument. Not only can U.S. investors buy foreign sovereign issues of developed countries, but they are practically default free.

Finally, we note the substantial U.S. direct investment in 3Q90 of $19 billion. This brings the 1990 total to $33 billion, just about equalling 1989's full year total. So, while portfolio investors took a cautious stance in 3Q90, U.S. investors significantly upped their stake in the global economy through direct investment.

Foreign Activity In U.S. Securities

Foreign Participation In The U.S. Equity Market Continues To Suffer



It was still another quarter of selling for foreign investors with net sales of U.S. equities of $2.4 billion during 3Q90. As has been the pattern this year, European

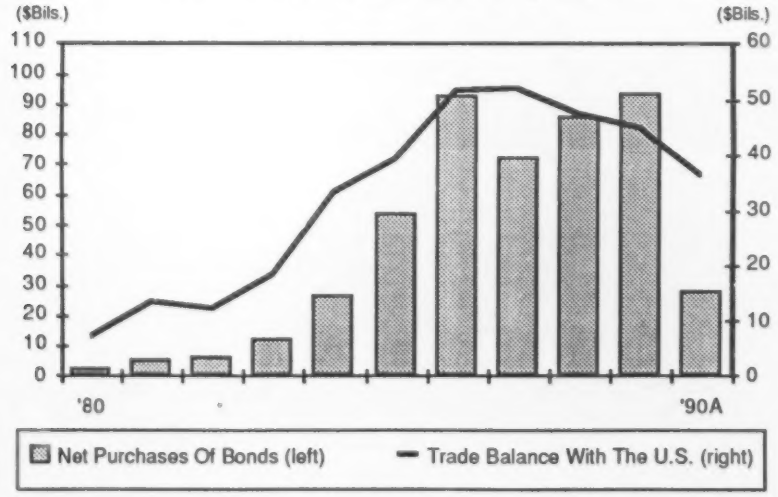
investors were the largest divestors of U.S. equities; net sales nearly reached $2.6 billion for the quarter and now total $6.2 billion for the year. For all foreign investors the year-to-date figure now stands at $9.2 billion and is in stark contrast to net purchases of $10.8 billion in the same period last year. Foreign investors though, made net purchases of U.S. equities totaling $1.4 billion in July, halting eight consecutive months of net sales. So, despite all the negatives, a declining dollar, rising interest rates, inflation worries and a weakening economy, foreign investors were following U.S. equity prices up to near record highs in July.

Foreign interest in U.S. equities, however, was abruptly interrupted this year. The eruption of the Mideast crisis in August quickly shifted the attitude of foreign investors away from U.S. equities; net sales totalled $1.3 billion in August. The pessimistic tone carried over into September as net sales exceeded $2.5 billion in that month alone.

Foreign Activity In U.S. Treasuries

Net purchases of U.S. Treasuries totalled $11.2 billion in 3Q90. Investors from Spain, the Netherlands and Germany were the most active net purchasers of U.S. government securities. Data available by type of investor (central bank or private sector) indicate that central banks were the major participants in this market. Given the sagging fortunes of the dollar in August, central banks may have decided to support the dollar by purchasing Treasury bonds rather than letting the dollar fall to "undesirable" levels. Despite central bank support, the buck still took a big hit in August, losing 6.1% to the Swiss Franc, 2.3% to the British Pound and nearly 1.4% to the Japanese Yen.

As The Japanese Trade Surplus With The U.S. Falls So Does Their Net Purchases Of Foreign Bonds



The Japanese continue to show little interest in U.S. Treasuries in 1990 andmade net purchases of only $445 million in 3Q90. This leaves their year-to-date divestment at a substantial $7.9 billion. Given a declining Japanese/U.S. trade surplus, economic difficulties in their home market, and new investment opportunities in Europe, support from these investors, the largest foreign investor in the U.S. Treasury market since the mid-1980's, may continue to cool. Indeed, data from the Japanese Ministry of Finance indicates that the Japanese investors' abandonment of foreign bonds in 1990 is worldwide, as net purchases on an annualized basis will be at there lowest level since 1983.

Foreign participation in the U.S. Treasury market continues to be cautious. At the current pace, net activity at the end of 1990 will be at its lowest level since 1983; hardly encouraging for a country with a troublesome budget deficit and a declining savings rate. While OPEC may re-cycle newly found petro-dollars into the U.S. Treasury market, at least temporarily serving as a buffer for the loss of Japanese and German capital, foreign capital will be harder to draw on given higher interest rate trends elsewhere along with strong foreign currencies. This means that the U.S. deficit will increasingly have to be financed domestically, a sharp reversal from trends in the 1980's. To many observers, this change in financing will be favorable for the U.S. in the longer run as we will have greater control over our own economy. However, in the shorter-term this turn of events means higher interest rates and a lower U.S. dollar, other things constant.

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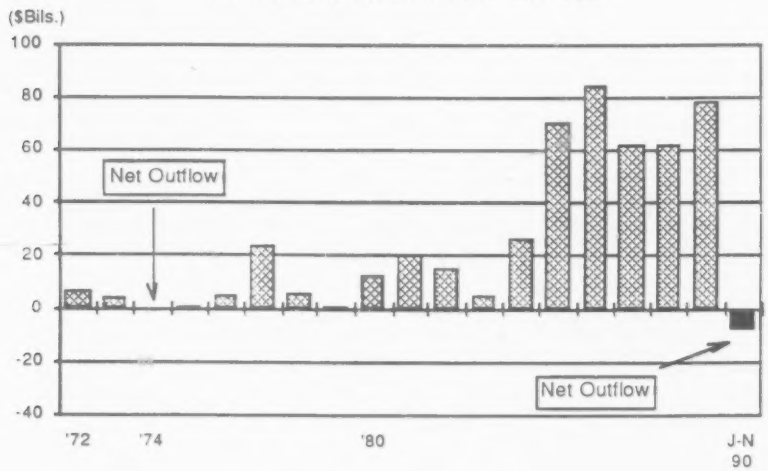
Capital Punishment

Portfolio flows in October and November 1990 followed a pattern similar to that of preceding months. Foreign private investors continued their flight from U.S. equities and Treasuries, while nibbling at government agency securities and corporate bonds. Foreign central banks continued to support the dollar with Treasury purchases. On the other hand, U.S. investors added to their record foreign securities acquisitions, with net purchases of foreign bonds more than offsetting net sales of foreign equities.

Net Portfolio Investment In The U.S.



The consonance of record U.S. portfolio outflows and the substantial reduction in foreign inflows in 1990 may result in negative portfolio flows (foreign inflows minus U.S. outflows) for the first time since 1974. That is, U.S. portfolio investment in foreign markets will exceed foreign portfolio investment in the U.S. market. This trend, in large part driven by the intensified worldwide competition for capital which the U.S. now faces from European and Asian

countries, may be the harbinger of a fundamental change. Indeed, the U.S. investor's strategy of diversification is now being facilitated by SEC rulings (144a, multijurisdictional proposals, etc.) that expand access to foreign securities. That is, the U.S. will face even stiffer competition for its own capital. The 1980s, a decade marred by conflicts over large *trade* imbalances, may give way to increased friction due to the competition for limited *capital* in the 1990s.

Foreign investors, still stung by the events of August, a declining U.S. equity market and a weakening dollar, continued to bail out of the U.S. equity markets in October and November. Moreover, their pace accelerated to net sales of $4.6 billion; the 1990 year-to-date total now stands at $14 billion. While information on individual countries is not yet available, data from the Bank of Japan suggests the Japanese contributed to the sell off. Japanese investors have made net sales of foreign equities in four consecutive months, August through November, confirming a Japanese pull-back from equity markets worldwide, not just the U.S.

It was not only U.S. equity markets that foreign investors abandoned during January through November. Net sales of U.S. Treasuries by private foreign investors, at $2.9 billion, are on their way to the lowest yearly level in more than a decade. Acquisitions of corporate debt totalling $11.7 billion, through November, are headed for a seven-year low. And, the $5.5 billion committed to U.S. agency bonds represents a three-year low. At a time when conventional thinking was for a lower interest rate environment, it is striking that foreign investors should reduce their purchases of U.S. fixed income instruments so substantially. The continued downward trend of the U.S. dollar, with tacit approval by most central banks, has no doubt played a large role in determining this investment posture. A declining dollar makes the price of U.S. assets attractive, but the belief that the value of these assets will continue to decline in dollar terms seems to have been an important factor in foreign investors' hesitance to purchase these securities.

Capital Punishment
($Bils.)

	Jan. 90 - Nov. 90	*Jan. 89 - Nov. 89*	*Net Change*
Equities	(14.0)	11.2	(25.2)
Treasuries	13.3	53.5	(40.2)
-Private	*(2.9)*	*27.8*	*(30.7)*
-Public	*16.2*	*25.7*	*(9.5)*
Corp. Bonds	11.7	16.1	(4.4)
Agencies	5.5	13.5	(8.0)
Total	$16.5	$94.2	($77.7)

What does all this translate to? For one, private foreign capital flows into the U.S. will ebb to the lowest level in more than a decade. All things constant, this means U.S. interest rates will be higher or, at least, higher than would otherwise be the case given past levels of foreign investment. And, with domestic saving showing no signs of inching up from its current anemic 3.5%-4.0%, the U.S. must attract foreign capital.

More ominously, with the U.S. federal and state deficits projected to increase in the coming years, the competition will increase between the public and private sectors for a reduced level of domestic funds. The U.S. will have to tap into a declining global savings pool to keep interest rates from rising and to meet its capital needs.

U.S. Investment Overseas

U.S. investors made net sales of almost $900 million of foreign equities in October through November, reducing 1990's year-to-date total to $6.6 billion. Despite this reduction, U.S. net purchases of foreign equities from January 1989 to November 1990 exceeded the total of all years from 1980 through 1988. During the same period, however, U.S. investors added an additional $2.7 billion of foreign fixed income instruments. Acquisitions of foreign bonds now total over $18 billion.

Foreign bond purchases were fueled by economic forces which have been in place nearly the entire year: yields abroad higher than those at home along with strengthening foreign currencies relative to the dollar. On the equity side, we believe U.S. investors sold off foreign equities to take advantage of rallies in the U.S. equity markets in November.

To date, U.S. investors have now committed nearly $25 billion to foreign markets, well above any prior full-year total. With foreign investors commiting just about $17 billion to the U.S. market, 1990 net portfolio outflows may well turn negative for the first time since 1974.

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March 27, 1991

1990: The Year That Wasn't

The first year of the new decade saw U.S. and foreign investors in agreement on at least one thing: non-U.S. securities were a better investment than U.S securities in 1990. Accordingly, U.S. investors made net purchases of nearly $31 billion in foreign securities while foreign investors made net acquisitions of U.S. securities totalling $23.2 billion. (Of the foreign inflow, $24.1 billion was accounted for by central bank purchases of U.S. treasury notes and bond.) The result is sobering; for the first time since 1974, the U.S. suffered a net portfolio outflow, with U.S. securities prices suffering from the decreased demand.

1990 Foreign Flows Into The U.S.:
The Year That Wasn't
($Bils.)

	1990	*1989*	*Net Change*
Equities	(15.3)	9.9	(25.2)
Treasuries	19.8	54.2	(34.4)
-Private	*(4.3)*	*27.4*	*(31.7)*
-Public	*24.1*	*26.8*	*(2.7)*
Agencies	6.5	15.1	(8.6)
Corp. Bonds	12.2	18.9	(6.7)
Total Portfolio	23.2	98.1	(74.9)
Total Direct	25.7	72.2	(46.5)
Total All	48.9	170.3	(121.4)

This sharp reversal in the foreign investors' posture is all the more stunning given that they made net purchases of U.S. equity and debt securities totalling $500

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billion in the 1980s, supporting U.S. equity prices and supplying much needed funds to the U.S. fixed-income markets. As noted in the previous table, net acquisitions of U.S. securities were only $23.2 billion in 1990, down by over four-fold from last year's record $98.1 billion, and the lowest level since 1983. The coldest shoulder was shrugged at the U.S. equity market, where net *sales* by foreigners reached a record $15.3 billion. Foreign interest in U.S. fixed-income instruments was also chilled as net purchases equalled $38.5 billion, down from $88.2 billion in 1989.

The previous table underscores an important element of foreign investor participation in the U.S. markets in 1990. Central banks were the only foreign investors that acquired U.S. securities, with foreign exchange intervention as their goal. They added to their holdings of U.S. securities by acquiring $24.1 billion of U.S. treasuries. On the other hand, foreign private investors actually made net sales of U.S. securities for the first time in over a decade. Acquisitions of U.S. fixed-income securities totalled about $14.4 billion, coupled with record net U.S. equity sales of $15.3 billion, resulted in an outflow of capital near $1 billion. Private investor decisions are motivated by returns on their U.S. investments relative to other opportunities. So, in a broad sense, they are an indicator of the future course of the U.S. economy relative to that of other nations. In addition, increased worldwide demands on capital serve to bring home, in a powerful way, that the U.S. can no longer expect a steady stream of foreign capital.

Foreign Activity In U.S. Equities

GROSS TRANSACTIONS IN AND NET PURCHASES OF
U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FULL YEAR 1989		FULL YEAR 1990		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE IN GA FY90-FY89
EUROPE	**$203,790**	**$1,010**	**$174,833**	**($8,579)**	**(14.2%)**
BELGIUM-LUXEMBOURG	14,044	346	12,992	(736)	(7.5%)
FRANCE	15,620	95	12,826	(1,183)	(17.9%)
GERMANY	15,747	(592)	12,160	(370)	(22.8%)
NETHERLANDS	7,387	6	6,122	(407)	(17.1%)
SWITZERLAND	32,934	(3,483)	27,845	(2,884)	(15.5%)
UNITED KINGDOM	97,217	4,507	92,880	(3,122)	(4.5%)
CANADA	**45,397**	**(867)**	**37,678**	**890**	**(17.0%)**
LATIN AMERICA & CARIBBEAN	**61,343**	**3,049**	**50,718**	**(1,347)**	**(17.3%)**
BERMUDA	12,701	1,329	11,082	(128)	(12.7%)
NETHERLANDS ANTILLES	18,568	744	16,521	(1,072)	(11.0%)
ASIA	**97,974**	**6,869**	**85,340**	**(5,952)**	**(12.9%)**
HONG KONG	9,021	139	9,041	(323)	0.2%
JAPAN	60,769	3,255	58,152	(2,907)	(4.3%)
OIL EXPORTING COUNTRIES	23,899	3,591	13,892	(2,447)	(41.9%)
TOTAL ALL COUNTRIES*	**$418,175**	**$9,946**	**$361,371**	**($15,301)**	**(13.6%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Foreign investors made net purchases of nearly $65 billion in U.S. equities during the 1980s. Combined with rising U.S equity prices in the 1980s, they upped their holdings of U.S. equities from $48.3 billion at the beginning of the 1980s to $257.4 billion at the end (equivalent to about 6.7% of equities outstanding) . Indeed, their appetite for U.S. equities was such in the 1980s that they were one of the largest positive influences on U.S. equity prices. The first year of the new decade showed a sharp reversal in the foreign investors' posture, with net sales totalling a record $15.3 billion and a reduction in holdings to $218.4 billion. Activity levels were also off sharply with transactions down to $361.4 billion in 1990, 13.6% less than 1989's $418.8 billion. While the size of the sell-off was unexpected, the factors which lead to it are fairly clear. Political and economic factors outside of the U.S., the increased demand for capital, higher interest rates, turmoil in the Japanese market and German reunification, just to name a few, made U.S. equities less appealing. Factors in the U.S., including federal budget gridlock, a declining dollar, and sinking U.S. equity prices, simply made the foreign investors' decision to leave the U.S. all the easier.

While the U.S. was a star performer compared to foreign markets in 1990, the downward path of the U.S. dollar was cause for concern for investors. True enough, the dollar on average only declined about 8%, but since its peak in 1985 it has declined about 32%, leaving foreign investors with substantial currency losses. Moreover, relative to the Yen, the dollar has declined over 39% and a near 45% devaluation against the deutschemark. The multi-year decline of the dollar, and its negative impact on the foreign investor's return on U.S. equities, helps explain the ferocity of the 1990s sell-off. This is particularly true of Japanese investors who were making record U.S securities purchases during this period. Indeed, we may not see sustained U.S. equity commitments by foreign investors until the U.S. greenback performs well, or at least shows some stability over some period of time. The current rise in the dollar, though disturbingly sharp, may be such a sign.

The sell-off was so complete that none of the countries analyzed in *FAR* made net purchases. Indeed, investors from France, Switzerland and the U.K. made net sales in each quarter of 1990. Japanese investors, beset by higher domestic interest rates and crumbling equity prices, divested $2.9 billion. As recently as 1987, these investors made net purchases of $11.7 billion.

OPEC members, 1989's largest acquirers of U.S. equities, made net sales of $2.4 billion in 1990. These investors had been steady sellers through the first three quarters of 1990, divesting $1.2 billion. The onset of hostilities in this part of the world in August 1990, and promises from various OPEC members to help fund the U.S. led coalition's efforts against Iraq, seems to have led to sales of U.S. equities. The future commitments which will have to now be made by these countries to help finance the rebuilding of Kuwait's infrastructure may lead to reduced equity investment by these countries in the future.

Foreign Participation In The U.S. Treasury Market

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

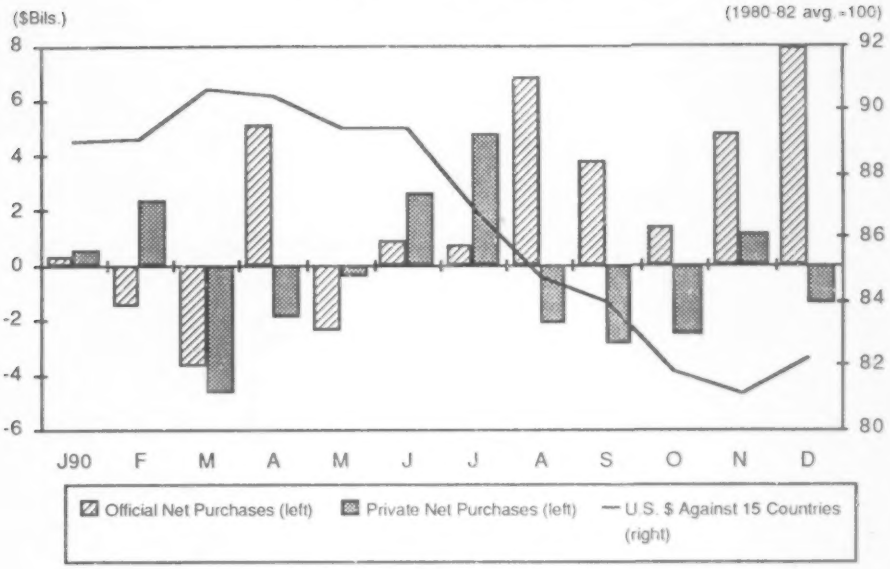
	FULL YEAR 1989		FULL YEAR 1990		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE IN GA FY90-FY89
EUROPE	**$1,557,058**	**$36,286**	**$1,507,211**	**$18,791**	**(3.2%)**
GERMANY	57,199	7,904	82,032	5,750	43.4%
SWITZERLAND	30,047	1,098	31,558	146	5.0%
UNITED KINGDOM	1,106,140	20,198	1,057,329	(2,159)	(4.4%)
ASIA	**2,198,065**	**13,297**	**1,808,611**	**(11,064)**	**(17.7%)**
JAPAN	1,886,989	1,681	1,552,619	(14,881)	(17.7%)
OIL EXPORTING COUNTRIES	115,288	8,148	78,464	(383)	(31.9%)
NONMONETARY INT'L & REGIONAL ORG'S	**148,045**	**1,902**	**211,203**	**(354)**	**42.7%**
TOTAL ALL COUNTRIES	**$4,140,362**	**$54,198**	**$3,634,604**	**$19,760**	**(12.2%)**

Source: U.S. Treasury

To discuss foreign activity in the U.S. treasury market during 1990, it is best to look at the substantially different postures taken by official institutions (central banks) and private investors. On the "positive" side, official institutions were net purchasers of U.S. treasuries totalling about $24.1 billion. This is in line with their average of $28.2 billion made during the period 1987-1989, when central banks attempted to give the rapidly declining greenback some support. Indeed, the graph below indicates that central bank net purchases in 1990 correlate closely with the dollar's decline.

On the other hand, foreign private investors made net divestitures of $4.3 billion, a dramatic about face from average net purchases of $28.2 billion made in 1987-1989. The dollar's decline, and more attractive foreign interest rates, laid the foundation for 1990's sell-off. Foreign private investors, looking to enhance their portfolios, decided that less was better than more in 1990.

Foreign Official And Private Participation
In The U.S. Treasury Market

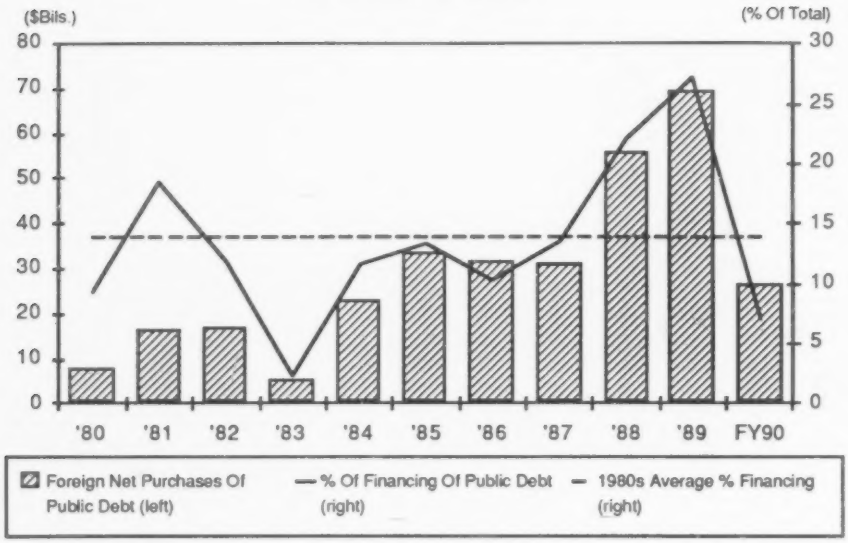


Japanese investors, by far, were the largest net sellers in 1990. Net sales totalled nearly $14.9, and left little doubt as to what the Japanese felt about U.S government securities. Increased yields on Japanese governments relative to those on U.S. issues, made U.S. bonds a poor choice. Significantly, Japanese investors made net sales of $7.6 billion in the fourth quarter alone. It may be speculation, but a portion of this selling may have been to raise dollars to help pay for America's role in the Gulf War. Indeed, a recent *Griggs & Santow Report* noted that foreigners have liquidated U.S. treasury investments to make war payments.

Other factors, including Japan's declining trade surplus with the U.S., increased opportunities in Europe and Latin America, and the tremendous build up of dollar-denominated assets in their portfolios since 1985, may continue to erode the levels of Japanese support in U.S.markets in general in the coming years. Underscoring the erosion in support were Japanese net sales of over $17 billion in U.S. securities in 1990. Since the signing of the Yen/Dollar Agreement in 1984, Japanese inflows had averaged about $20 billion per year through 1989.

We've updated the following chart (previously in our 2Q90 issue) because we believe it is instructive as to the impact of the reduction in foreign interest in the U.S. public debt market. Foreign net acquisitions of U.S. public debt (including both treasuries and agencies) totalled $26.3 billion in 1990, accounting for only 7% of the U.S. federal government's financing needs. This is well below the previous two years, and is half the 1980's average.

Foreign Support (Or Lack Of) In The U.S. Public Debt Market



This means that the U.S. was increasingly reliant on its own domestic funds to support deficit financing in 1990, draining domestic savings from equity markets to the debt markets. With increasing federal, state and local deficits ahead, and a low (and even decreasing) national savings rate, it may be that higher taxes, higher interest rates, or a combination, may be an unwelcome byproduct of the diminished foreign appetite for U.S. government securities. Either way, it seems that this scenario could result in constraints on future economic growth and expansion. Alternatively, a serious effort to cut government spending, along with increased savings, may prove more prudent.

U.S. Participation In Foreign Securities

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FULL YEAR 1989		FULL YEAR 1990		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE IN GA FY90-FY89
EUROPE	**$127,890**	**$10,096**	**$151,640**	**$3,424**	**18.6%**
EUROPEAN COMMUNITY	*$117,373*	*$8,001*	*$139,484*	*$3,796*	18.8%
BELGIUM/LUXEMBOURG	2,066	110	2,468	178	19.5%
DENMARK	525	37	653	117	24.4%
FRANCE	7,971	1,937	11,874	(162)	49.0%
GERMANY	6,891	373	14,109	725	104.7%
GREECE	18	6	55	9	205.6%
IRELAND	478	238	233	109	(51.3%)
ITALY	5,690	(456)	7,428	820	30.5%
NETHERLANDS	6,933	1,295	7,924	764	14.3%
PORTUGAL	66	56	70	36	6.1%
SPAIN	6,653	(629)	4,945	873	(25.7%)
UNITED KINGDOM	80,082	5,034	89,725	331	12.0%
SWITZERLAND	8,469	1,933	8,861	(565)	4.6%
CANADA	**10,870**	**1,278**	**9,636**	**96**	**(11.4%)**
LATIN AMERICA & CARIBBEAN	**9,296**	**360**	**9,887**	**1,937**	**6.4%**
MEXICO	315	7	2,005	909	536.5%
ASIA	**75,775**	**555**	**74,434**	**1,794**	**(1.8%)**
JAPAN	65,804	756	62,353	613	(5.2%)
OTHER	**8,844**	**808**	**13,732**	**1,146**	**55.3%**
TOTAL ALL COUNTRIES*	**$232,675**	**$13,097**	**$252,476**	**$8,407**	**8.5%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

U.S. interest in foreign securities reached record heights in 1990. Net acquisitions of all foreign securities totalled $30.8 billion in 1990, up from the previous year's $19.1 billion. The asset mix was sharply different, though. Consistent with the higher interest rate, lower equity price environment, the table below indicates the shift toward fixed-income instruments in 1990, with record acquisitions of $22.4 billion. On the other hand, net purchases of equities fell to $8.4 billion from 1989's record $13.1 billion. Even though, we should note, U.S. net acquisitions of foreign equities in 1990 were still the second highest level ever. Declining world equity prices dropped U.S. holdings of foreign equities from $95.8 billion in 1989 to $90.5 billion.

Performance Of Major Securities Market Indicators In 1990

	Equity Return (local terms)	*Long Bond*** (end period)	*Dollar Movement** (year avg.)
U.S.	-6.8%	8.1%	N/A
U.K.	-12.8%	11.2%	-9.1%
Canada	-14.4%	10.3%	-0.8%
Germany	-20.1%	9.0%	-13.8%
Switzerland	-21.8%	6.7%	-15.2%
France	-25.7%	10.0%	-14.7%
Japan	-40.4%	7.1%	4.9%

*Calendar Year Average
**End Period

Source: FT-Actuaries World Indices; Goldman Sachs International Limited

We also note that U.S. direct investment, at $36.4 billion, is also a record. And, for the first time since 1980, U.S. direct investment in foreign markets exceeded foreign direct investment in the U.S. The significant capital outflows in the past two years suggest that U.S. investors are increasingly sanguine about the growth opportunities in foreign markets.

U.S. Net Purchases Of Foreign Financial Assets
($Bils.)

	1990	*1989*
Equities	$8.4	$13.1
Debt	22.4	6.0
Direct Investment	36.4	31.7
Total	$67.2	$50.8

Turnover in both fixed-income and equity securities reached records. U.S. transactions in foreign bonds, a record $649.5 billion, was up 36.9% over 1989's $474.5 billion. The lure of strengthening foreign currencies and high overseas bond yields served to attract U.S. investment in foreign markets at a record clip. In foreign equities, transactions totalled $252.5 billion, up 8.5% over the previous year's $232.7 billion.

In 1990, we noted the U.S. investor's increased willingness to commit capital to less traditional markets. The prize of this class has been Mexico, where U.S. investors

committed over $900 million to Mexican equities, larger than any other country covered in *FAR*. The money was well committed; returns on Mexican equities totalled 79.6% in U.S. dollar terms. In addition, $343 million was placed in Mexican fixed-income instruments. The Salinas government's economic reforms, which include the opening of the Mexican securities markets to foreign parties, seems to be having its intended impact. Indeed, as a bonus, flight capital seems to be returning. Using U.S. bank liabilities to Mexican private investors as a proxy, we note that liabilities have dropped from a peak of $12.6 billion at 12/31/88 to $9.7 billion at the end of 1990, a decline of 23%.

U.S. investors seemed to attach almost equal importance to Spanish equities, where acquisitions reached $873 million. While the Spanish market dropped 14% in U.S. dollar terms during 1990, increased M&A activity, and a continuation of stepped up efforts to diversify into European stocks, may have helped to attract U.S. investment.

The last two years have sent a clear signal that U.S. investors are becoming major players in world securities markets. Economic and political reforms being implemented in Europe, Asia and Latin America should open U.S. investors, and "foreign" investors, to entire new areas of opportunity. In this "new world order", the U.S. will compete for both domestic and foreign capital.

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A88 25-2

FOREIGN ACTIVITY

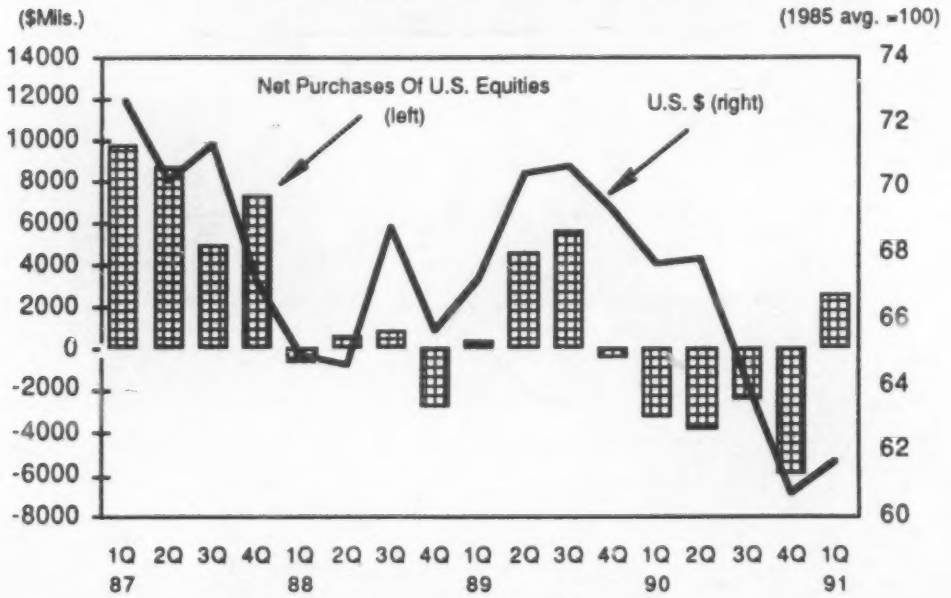
An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

Vol.XVI, No. 3 June 26, 1991

Here Comes The Sun

Foreign investor displeasure has been readily apparent -- five consecutive quarters of net sales of U.S. equities totalling $15.8 billion. But, the 1Q91 U.S. equity market rally, supported by declining interest rates, and combined with a rapidly rising dollar, brought $2.6 billion of new foreign money into U.S. equities. While the U.S. equity surge certainly caught the attention of the foreign investor, the chart below indicates that the foreign investor's posture, at least during the time period shown, has been strongly influenced by the direction of the U.S. currency.

The Declining U.S. Dollar Was A Key Ingredient In Foreign Investor Divestitures Of U.S. Equities



In the latter part of the 1980s, the foreign investor's decision to commit money to U.S. equities was made only after negotiating the U.S. version of an economic obstacle course. A declining dollar, rising budget deficits, downgrading of the debt

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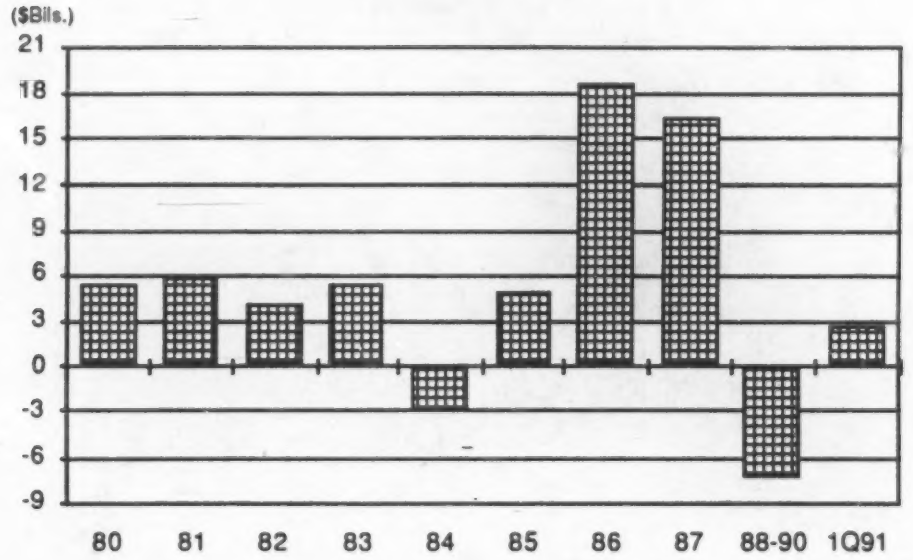
rating of many corporations, protectionist sentiment, unexciting U.S. equity prospects, and talk of a recession, sent foreign investors looking elsewhere. Yet, the vigor of the 1Q91 U.S. equity and dollar rallies seems, at least for the meantime, to have been strong enough to offset the doubts foreign investors had about U.S. equities in the past years.

Foreign investors were initially hesitant to take part in the U.S. equity rally as net sales in January 1991 totalled $807 million. The surprise pick up in the U.S. dollar, which began in February, provided the impetus for foreign purchases. Acquisitions in February and March rocketed to $1.08 billion and $2.37, respectively. Indeed, March's $2.37 billion was the largest monthly takedown since September 1989. Foreign investors may also have used 1Q91 to stem the sharp decline in their holdings of U.S. equities. These holdings, which peaked at the end of 3Q89 at $260 billion, were subsequently pared to $217.2 billion at end-1990, a 16.5% decrease. The rise in U.S. equity prices in 1Q91 helped push up holdings to $252.1 billion. Given evidence that investors have been stepping up their purchases of European equities, however, investors may still be well under-weighted in U.S. equities.

Foreign Net Activity In U.S. Equities



The foreign investor's return to the U.S. market is of some importance. In light of the spate of U.S. IPOs in 1Q91, which totalled $2.7 billion, foreign investors may have played a role in the market's 1Q91 rally by supplementing U.S. demand. In that U.S. companies will begin to re-equitize their balance sheets in the 1990s, this is a much welcome turnaround.

Foreign investors also made net purchases of U.S. Treasuries. Acquisitions, at about $900 million, were minimal. Yet, private investor acquisitions were $2.8 billion in 1Q91. While, this is well off the banner years of the mid to late 1980s, it does represent the largest private acquisitions of U.S. Treasuries since 4Q89. On the other hand, foreign official institutions were net sellers of U.S. Treasuries in 1Q91, likely a result of intervention intended to blunt the rapid ascent of the U.S. dollar.

Foreign Acquisitions Of U.S. Financial Assets

($Bils.)

	1Q91	*4Q90*	*Net Change*
Equities	2.6	(5.9)	8.5
Treasuries	0.9	11.3	(10.4)
-Public	*(1.8)*	*14.0*	*(15.8)*
-Private	*2.8*	*(2.7)*	*5.5*
Agencies	0.9	3.2	(2.3)
Corp. Bonds	2.8	3.5	(0.7)
Total Portfolio	7.2	12.1	(4.9)
Total Direct	2.0	4.5	(2.5)
Total All	9.2	16.6	7.4

Finally, we note the foreign direct investment only increased $2 billion in 1Q91. The smallest quarterly increase since 4Q83 is one more indication that the foreign rush to buy U.S. assets in the 1980s has since slowed to a trickle.

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FOREIGN ACTIVITY

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

Vol. XVI, No. 4 August 8, 1991

Internationalization Continues

A combination of economic and world events set the back-drop for foreign activity in 1Q91. Declining interest rates, a soaring dollar, and a stunning victory in Iraq by U.S.-led coalition forces, created a positive atmosphere for investment in U.S. securities. For the first time since the third quarter of 1989, foreign investors were net purchasers of U.S. equities, $2.5 billion. U.S. investors, continuing the substantial acquisitions of the past two years, added $10 billion of foreign securities to their portfolios in 1Q91.

Foreign Activity In U.S. Equities

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$39,354**	**($2,484)**	**$52,847**	**($1,153)**	**34.3%**
BELGIUM-LUXEMBOURG	2,519	(175)	3,412	(14)	35.5%
FRANCE	2,737	(288)	3,669	82	34.1%
GERMANY	2,173	(245)	3,424	(318)	57.6%
NETHERLANDS	1,362	(86)	2,498	(128)	83.4%
SWITZERLAND	5,559	(645)	9,400	(808)	69.1%
UNITED KINGDOM	21,332	(820)	25,999	(99)	21.9%
CANADA	**9,736**	**650**	**11,822**	**778**	**21.4%**
LATIN AMERICA & CARIBBEAN	**12,272**	**(346)**	**15,098**	**1,174**	**23.0%**
BERMUDA	2,953	224	2,307	45	(21.9%)
NETHERLANDS ANTILLES	3,799	(573)	5,410	934	42.4%
ASIA	**17,468**	**(3,583)**	**22,806**	**1,824**	**30.6%**
HONG KONG	2,389	(222)	2,337	397	(2.2%)
JAPAN	11,367	(1,711)	13,340	(640)	17.4%
OIL EXPORTING COUNTRIES	2,940	(1,239)	4,245	366	44.4%
TOTAL ALL COUNTRIES*	**$80,875**	**($5,876)**	**$104,586**	**$2,496**	**29.3%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

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Foreign investors returned to the U.S. equity market in 1Q91, with net purchases of $2.5 billion. This follows a stretch of five consecutive quarters of net sales totalling $15.8 billion. In a geographic sense, however, the appeal of U.S. equities was not widespread. European investors continued to sell-off U.S. equities, with net sales for the quarter totalling $1.15 billion. Among the European countries reviewed, only France made net purchases, and a mere $82 million at that. The following table illustrates that European investors have been significant sellers of U.S. equities for over a year. While 1990's divestitures were dollar related, the European markets were down 6.1% during this period in contrast to a 6.3% gain for U.S. markets. Nevertheless, despite generally declining domestic markets, European investors looked at home for growth prospects and sold on dollar weakness.

Net Activity By European Investors In U.S. Equities, 1990-1Q91

($Bils.)

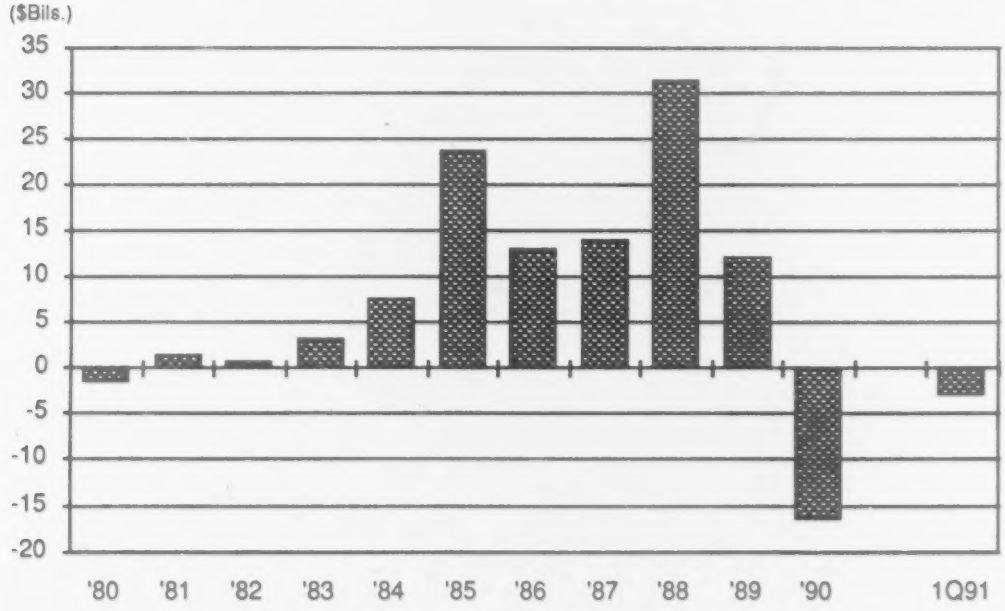
Europe	(9,732)
Belgium-Luxembourg	(750)
France	(1,101)
Germany	(688)
Netherlands	(535)
Switzerland	(3,692)
United Kingdom	(3,221)

Canadian investors made substantial acquisitions of U.S. equities in 1Q91. Indeed, the first-quarter takedown of $778 million nearly matched last year's total acquisitions of $890 million. For the last three quarters, Canadian acquisitions of U.S. equities total $2.1 billion, making these investors the largest foreign purchases of equities.

Several reasons may help to explain this posture. Relatively speaking, the Canadian equity market has performed "poorly." For example, Canadian equities rose about 5.2% in 1Q91 compared to a 14% rise in U.S. equity prices. Indeed, this follows a decade where Canadian equity prices rose at an annual rate of about 6%. Second, new Canadian regulations allow for increased allocation of foreign securities to Canadian pension fund portfolios. Thirdly, as noted in an earlier issue of SIA's *ICMR*, the foreign assets held by Canadian investors grew by only 7% in the 1984-1989 period, compared to about 15% growth in U.S. holdings and 30% in Japanese holdings. Canadian investors may be attempting to more heavily weight their portfolios with foreign assets.

Investors from Asia made U.S. equity acquisitions of $1.8 billion. However, the 1990s are continuing to make the story of the 1980s, that of Japanese investment in U.S. equities, look like a historical artifact. Coming on top of 4Q90 equity divestitures of $1.7 billion, these investors made net sales of $640 million in 1Q91. In a broader context, the exit of the Japanese investor from U.S. securities has been just as swift as their entry. Since the large inflows of the mid-1980s, Japanese investors have seen their U.S. portfolios rocked by a 42% dollar decline, which nearly wiped out a 56% rise in the S&P 500 during the period. Similarly, according to the *Salomon Brothers World Government Bond Index*, Japanese investors received a cumulative Yen-based total return in U.S. government bonds of 4.1% from end-1985 to end-1989. While undoubtedly some of the currency risk was hedged, the Japanese investors found themselves swimming up-stream from the mid-to-late 1980s. However, we would be naive not to acknowledge the current "scandal" in the Japanese markets and the sharp plunge in equity prices causing many Japanese to sell foreign holdings and focus on their domestic market.

Japanese Net Purchases
Of U.S. Securities



Some support for the U.S. market came from Hong Kong, $397 million, and OPEC, $369 million. However, the largest support came from Singapore, with net acquisitions of $1.7 billion. Given the serious restrictions on foreign investment on Singapore residents, it is likely that official institutions were the acquirers.

Foreign Investment In U.S. Treasuries

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$392,248**	**$6,776**	**$441,492**	**$1,722**	**12.6%**
GERMANY	28,284	2,829	29,917	(5,806)	5.8%
SWITZERLAND	6,936	813	9,442	778	36.1%
UNITED KINGDOM	263,173	(3,121)	287,922	3,288	9.4%
ASIA	**384,222**	**(6,193)**	**435,272**	**3,608**	**13.3%**
JAPAN	327,097	(7,619)	362,311	(2,821)	10.8%
OIL EXPORTING COUNTRIES	19,433	(1,111)	23,063	(318)	18.7%
NONMONETARY INT'L & REGIONAL ORG'S	**56,792**	**285**	**44,110**	**(1,082)**	**(22.3%)**
TOTAL ALL COUNTRIES*	**$924,221**	**$11,313**	**$1,129,240**	**$870**	**22.2%**

Source: U.S. Treasury
* Activity incorporates revised data

Net activity in U.S. Treasuries sank to under $900 million in 1Q91, while transactions climbed over 22% to $1.1 trillion. The net numbers mask an interesting story—official institutions bought $13.2 billion of U.S. Treasuries in February, only to make net sales of a whopping $15.3 billion in March. February's net purchases may have been to prop up the U.S. dollar in the wake of an increase in official German interest rates and a cut in U.S. rates. However, in mid-February, the dollar began a long-anticipated rise against major foreign currencies. March net sales were a sign of coordinated intervention by the G-7 countries to cap the rise of the dollar. The speed of the rise, particularly against the DM, may have jolted central bankers into massive selling of the dollar.

German investors made net sales of U.S. Treasuries totalling $5.6 billion in 1Q91, nearly offsetting last year's net purchases of $5.7 billion. The size of these divestitures suggests that the German central bank did indeed make substantial dollar sales in order to slow, if not stop, the rise of the greenback.

Flows Into The U.S. Treasury Market, 1Q91-1990

($Bils.)

Largest Acquirers		*Largest Divestors*	
Spain	10.5	Japan	(17.7)
Taiwan	7.0	Int'l Orgs	(1.6)
Netherlands Antilles	6.9	Oil Exporting Countries	(0.7)
Mexico	2.8	France	(0.6)
Denmark	2.8	Korea	(0.3)
United Kingdom	2.0	Venezuela	(0.2)

Support for the U.S. Treasury market came from countries not often associated with large U.S. inflows. Spain, last year's largest buyer of U.S. Treasuries at $6.8 billion, made net purchases of $3.7 billion. Some of this support may have come from the Spanish central bank, which at the end of March 1991 held a considerable $49.9 billion in foreign exchange reserves. Coincidentally, at the beginning of 1990, Spanish foreign exchange reserves totalled $39.5 billion, about $10.5 billion less than March 1991's $49.9 billion.

A number of factors stemming from developments in 1989 may also help explain the Spanish private investor's interest over the past year. For one, the Spanish decision to join the EMS reduced the volatility of the peseta relative to other European currencies. Second, an increase in the withholding tax on government bonds made Spanish fixed-income instruments relatively less attractive. Third, a credit ceiling was imposed on Spanish bank lending to the private sector. These three factors all had the impact of reducing returns at home and forcing Spanish investors to look elsewhere for a higher yield.

Finally, prior to November 1989, Spanish banks were forced to make obligatory deposits to hold against their foreign exchange positions. (A deposit of 20% of any increase in foreign exchange position must be held.) The abolition of this requirement in November made foreign currencies, as well as foreign bonds, more attractive to hold.

U.S. Investment In Foreign Securities

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

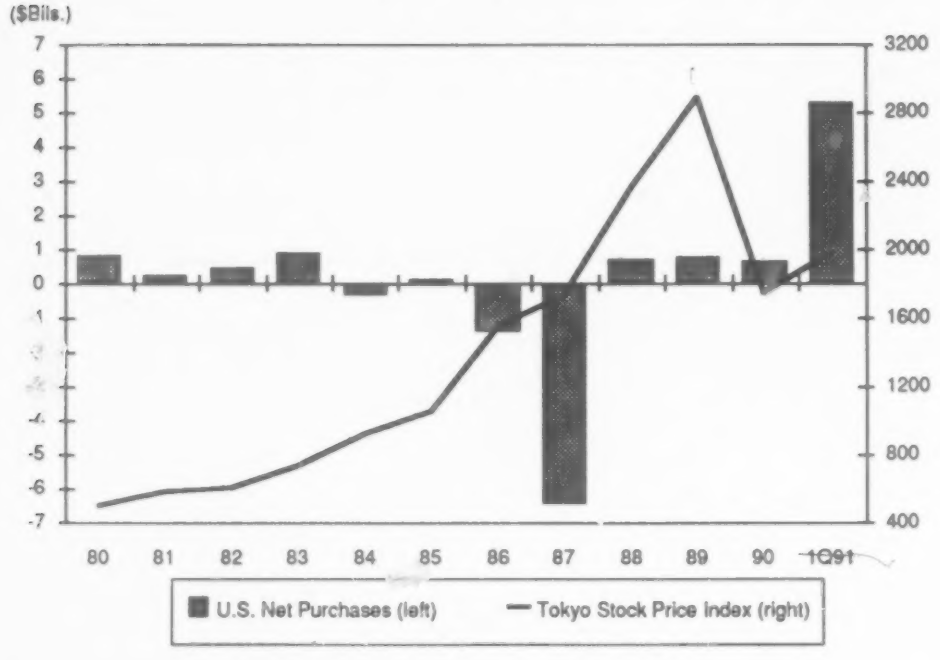
	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$31,589**	**($589)**	**$36,958**	**$2,332**	**17.0%**
EUROPEAN COMMUNITY	*$29,200*	*($510)*	*$33,269*	*$1,761*	*13.9%*
BELGIUM/LUXEMBOURG	451	13	471	(35)	4.4%
DENMARK	90	16	132	30	46.7%
FRANCE	2,209	73	2,618	106	18.5%
GERMANY	2,416	272	3,203	645	32.6%
GREECE	26	6	8	2	(69.2%)
IRELAND	23	(1)	52	(30)	126.1%
ITALY	967	(81)	1,676	252	73.3%
NETHERLANDS	2,080	330	1,975	(187)	(5.0%)
PORTUGAL	20	4	10		(50.0%)
SPAIN	791	(151)	1,250	128	58.0%
UNITED KINGDOM	20,127	(991)	21,874	850	8.7%
SWITZERLAND	1,532	(50)	2,456	290	60.3%
CANADA	**1,982**	**(162)**	**2,709**	**(385)**	**36.7%**
LATIN AMERICA & CARIBBEAN	**2,268**	**720**	**2,417**	**(241)**	**6.6%**
MEXICO	749	497	532	146	(29.0%)
ASIA	**17,094**	**606**	**18,853**	**5,275**	**10.3%**
JAPAN	13,582	250	15,996	5,230	17.8%
OTHER	**1,322**	**507**	**1,153**	**43**	**(12.8%)**
TOTAL ALL COUNTRIES*	**$54,255**	**$1,082**	**$62,658**	**$6,886**	**15.5%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

With the stimulus provided by a sweeping victory in the Mid-East and declining short-term interest rates, U.S. equities posted a 1Q91 total return of 15.1%. Despite the broad scope of the U.S. market surge, U.S. investor interest in foreign equities continued unabated. Indeed, U.S. acquisitions of foreign equities in 1Q91 reached a quarterly record $6.9 billion. Surprisingly, the lion's share of U.S. capital, nearly $5.3 billion, was sent to Japan.

U.S. investors were barely bit players in Japanese equities in the 1980s. During this period, U.S. investors not only watched the Tokyo Stock Index (local terms) increase over 6 times but actually divested $4.2 billion worth of Japanese equities. Despite a near 40% decline in Japanese equity prices in 1990, U.S. investors made acquisitions of $5.3 billion in 1Q91.

U.S. Net Purchases Of Japanese Equities



U.S. investors used a similar strategy in Germany. After watching German equity prices end 1990 down 28% from their March 1990 peak, U.S. investors made net purchases of $645 million, their second highest level over. While the future cost of a unified Germany continues to cloud any investment strategy, U.S. investors, as highlighted by their dollar commitments, are keeping a foot in the door.

Mexican equities continued as a U.S. investment favorite. An additional $146 million was invested in Mexican shares, bringing the most recent five-quarter takedown to almost $1.7 billion. During this 15 month period, Mexican equity prices rocketed 170% (142.7% in U.S. dollars).

Despite a 5% increase in Canadian equity prices in 1Q91 (a global basket returned 14%), U.S. investors continued to move out of Canadian equities as concern over the depth of the Canadian recession grew. Net sales in 1Q91 totalled $385 million. High interest rates and a recession have made U.S. and foreign investors adopt a cautious stand toward Canadian equities.

U.S. interest in foreign fixed-income products also continued. After making acquisitions of over $22 billion last year, investors purchased another $3.1 billion in 1Q91. However, 1990's impressive returns on foreign bonds were not to be found in 1Q91. Indeed, the best performers of last year, which showed returns of over 20%, slipped into the negative in 1Q91 as the surging U.S. dollar led to currency losses.

Substantial acquisitions of French bonds have been made recently, over $3 billion during 4Q90 and 1Q91. As with other European fixed-income instruments, French bonds offered generous yields last year. Combined with an increase in the French franc relative to the dollar, French bonds showed a total return of 23.5% (U.S. $ terms) in 1990; the third best performing bond market for U.S. investors. However, the dollar's surge in 1Q91 transtated to a reversal in the U.S. investor's fortune: while French bonds rallied, French bonds returned (7.0%) to U.S. investors.

1Q91 Total Rates Of Return For Selected Government Bond Markets

	U.S. $	*Local Currency*
C$	6.17	5.98
A$	5.59	5.19
U.S.$	2.00	2.00
¥	(2.16)	1.99
£ Sterling	(4.17)	6.53
Ffr	(6.96)	6.05
Dfl	(9.30)	3.67

Source: Salomon Brothers Inc

Canadian fixed-income instruments have lately been a staple of U.S. investors. First-quarter net acquisitions of $1.8 billion followed last year's record takedown of about $6.8 billion. As the spread between Canadian governments and U.S. bonds has increased over the past few years, particularly in real terms, Canadian bonds have become increasingly attractive.

David G. Strongin
Director, International
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GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN BONDS BY U.S. INVESTORS
($Mils.)

	FOURTH QUARTER 1990		FIRST QUARTER 1991		% CHANGE
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	IN GA 1Q91-4Q90
EUROPE	**$126,117**	**$443**	**$135,838**	**$714**	**7.7%**
EUROPEAN COMMUNITY	$118,533	$251	$127,847	$587	7.9%
BELGIUM/LUXEMBOURG	2,762	(142)	3,927	173	42.2%
DENMARK	1,644	284	3,372	(174)	105.1%
FRANCE	12,712	1,504	11,272	1,538	(11.3%)
GERMANY	9,546	1,036	12,230	(1,918)	28.1%
GREECE	1	**	48	(26)	**
IRELAND	667	101	398	(16)	(40.3%)
ITALY	4,747	49	5,295	283	11.5%
NETHERLANDS	7,337	859	3,873	453	(47.2%)
PORTUGAL	28	(26)	47	(41)	67.9%
SPAIN	1,118	(240)	1,991	197	78.1%
UNITED KINGDOM	77,972	(3,174)	85,394	118	9.5%
SWITZERLAND	2,781	11	2,773	(43)	(0.3%)
CANADA	**22,855**	**2,921**	**20,001**	**1,753**	**(12.5%)**
LATIN AMERICA & CARIBBEAN	**9,778**	**1,420**	**11,995**	**(539)**	**22.7%**
MEXICO	365	101	235	15	(35.6%)
ASIA	**42,985**	**943**	**36,222**	**(170)**	**(15.7%)**
JAPAN	36,018	1,092	28,028	650	(22.2%)
OTHER	**8,352**	**1,670**	**8,055**	**1,351**	**(3.6%)**
TOTAL ALL COUNTRIES*	**$210,087**	**$7,397**	**$212,111**	**$3,109**	**1.0%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions
** Less than $1000

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FOREIGN ACTIVITY

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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Reversal Of Fortune

In the first half of 1991, foreign investors enjoyed a combination of declining U.S. interest rates, a strengthening dollar and a sharp rise in equity prices, with the Dow passing 3000 for the first time in April. Further bouyed by hope for a U.S. economic recovery, foreign investors turned to the U.S. equity market. With net purchases of $7.7 billion in 2Q91 -- the largest quarterly takedown since 2Q87's $8.7 billion -- cumulative first-half acquisitions rose to an impressive $10.4 billion. Considering last year's record $15.1 billion sell-off, the 1H91 equity *inflow* is all the more impressive. In addition, acquisitions of U.S. treasuries, at $14.1 billion, also proved surprising. In total, first-half net purchases of U.S. securities neared $36 billion.

Foreign investors not only reversed last year's pessimistic posture, but showed that despite the worldwide need for capital, the U.S. capital markets can continue to attract foreign funds when U.S. economic indicators appear favorable. However, we do not expect that the U.S. would attract the levels of foreign capital seen in the later part of 1980s; because of this, the U.S. will increasingly rely on a shrinking pool of domestic savings to finance its growth.

1H91 Foreign Flows Into The U.S.:
Better Than Expected
($Bils.)

	1H91	*1H90*	*Net Change*
Equities	10.4	(7.0)	17.4
Treasuries	14.1	(2.5)	16.6
-Private	*19.0*	*(1.3)*	*20.3*
-Public	*(4.9)*	*(1.2)*	*(3.7)*
Agencies	2.2	3.7	(1.5)
Corp. Bonds	9.2	7.9	1.3
Total Portfolio	35.9	2.1	33.8
Total Direct	7.6	25.6	(18.0)
Total All	43.5	27.7	15.8

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The 1H91 foreign inflows contrasts with the 1980s, where institutional investors, particularly those whose foreign asset holdings were artificially constrained by capital controls, built up dollar holdings irrespective of, for instance, the falling dollar. In that most major capital suppliers, particularly the Japanese, built large dollar positions during the 1980s, the need to invest in the U.S. will more often be driven by the economy, and less by dollar allocation. Put slightly differently, the foreign fund manager is increasingly looking at returns on capital and is less interested in the allocation of the total portfolio between dollars and other currencies as in the past.

Foreign Activity In U.S. Equities

GROSS TRANSACTIONS IN AND NET PURCHASES OF
U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1991		*SECOND QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q91-1Q91*
EUROPE	**$52,847**	**($1,153)**	**$55,508**	**$3,576**	**5.0%**
BELGIUM LUXEMBOURG	3,412	(14)	3,556	200	4.2%
FRANCE	3,669	82	4,124	208	12.4%
GERMANY	3,424	(318)	3,396	86	(0.8%)
NETHERLANDS	2,498	(128)	2,245	119	(10.1%)
SWITZERLAND	9,400	(808)	8,977	1,187	(4.5%)
UNITED KINGDOM	25,999	(99)	29,032	1,124	11.7%
CANADA	**11,822**	**778**	**12,293**	**1,205**	**4.0%**
LATIN AMERICA & CARIBBEAN	**15,098**	**1,174**	**16,008**	**644**	**6.0%**
BERMUDA	2,307	45	2,847	(115)	23.4%
NETHERLANDS ANTILLES	5,410	934	4,670	66	(13.7%)
ASIA	**22,806**	**1,824**	**20,596**	**1,728**	**(9.7%)**
HONG KONG	2,337	397	1,803	65	(22.8%)
JAPAN	13,340	(640)	13,084	1,908	(1.9%)
OIL EXPORTING COUNTRIES	4,245	366	4,116	(435)	(3.0%)
TOTAL ALL COUNTRIES*	**$104,777**	**$2,649**	**$106,550**	**$7,704**	**1.7%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

European investors' second-quarter commitment to the U.S. was widespread, with all European countries analyzed in the *FAR* showing net purchases. Foreign investors, prodded by an "I'm missing the rally" mentality, used the strengthening dollar as a platform to jump back into the U.S. equity market. In addition, the dramatic political and economic transformations taking place in Eastern Europe are making European investors uncertain as to the potential positive impact of a unified Europe on

economic growth. In this case, investment in the U.S. may seem an attractive alternative.

The long lost Swiss investor also returned in 2Q91. Dating back to the 4Q87, Swiss investors have made net sales of U.S. equities in every quarter, totalling $10.3 billion. As the table below shows, the Swiss were, by far, the largest divestors of U.S. equities since 4Q87. During this period of divestment, the Swiss market has outperformed Europe as a whole, and by the end of the 1H91, had performed as well as the U.S. market. Moreover, from mid-1985 to the beginning of 1990 the Swiss market significantly outperformed the U.S. market. So, to some extent, this trend is not surprising.

Foreign Net Purchases Of U.S. Equities, 2Q91-4Q87

($Mils.)

Japan	5,696
Canada	3,706
Belgium/Luxembourg	(142)
Netherlands	(481)
Germany	(1,195)
OPEC	(1,716)
France	(2,508)
U.K.	(3,675)
Switzerland	**(10,262)**

Ironically, not only did the Swiss actually lead the European march back into U.S. equities -- 2Q91 net purchases totalled near $1.2 billion -- but also acquired a record quarterly level for customers of Swiss intermediaries. Despite the conservative nature of the Swiss investor, the severe paring of their dollar-based equity holdings during the past years may have led to a decision to rebuild. With the dollar showing continued strength, inflation in Switzerland running at a decade high, and economic growth among the weakest in Europe, the timing was opportune to purchase U.S. equities.

Canadian investors made net purchases of $1.2 billion in 2Q91, a record quarterly takedown. Indeed, Canadian investors are well on their way to record acquisitions of U.S. equities in 1991. Given the recent poor performance of Canadian markets and a deepening recession, the U.S. market has become something of a home-away-from-home for Canadian investors. Moreover, the phased in increase for Canadian pension fund holdings of foreign assets, as well as the implementation of the Multi-jurisdictional Disclosure System, which will facilitate cross-border equity offerings between the U.S. and Canada, should lead to greater interest in the U.S. market and vice versa.

The recent cautious attitude of Japanese investors toward U.S equities was reversed in 2Q91; net acquisitions of $1.9 billion surpassed that of any other country. While we don't expect a re-emergence of substantial flows of Japanese capital to the U.S. -- net capital outflows from Japan 1H91 turned inward for the first time since 1980 -- the strong performance of the dollar may still entice Japanese investors.

Foreign Activity In U.S. Treasuries - Dutch Treat

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1991		*SECOND QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q91-1Q91*
EUROPE	**$441,492**	**$1,722**	**$405,677**	**($55)**	**(8.1%)**
GERMANY	29,917	(5,606)	20,084	(574)	(32.9%)
SWITZERLAND	9,442	778	8,182	(186)	(13.3%)
UNITED KINGDOM	287,922	3,288	273,996	708	(4.8%)
ASIA	**435,272**	**3,608**	**411,851**	**(3,051)**	**(5.4%)**
JAPAN	362,311	(2,821)	340,585	(1,245)	(6.0%)
OIL EXPORTING COUNTRIES	23,063	(318)	18,625	(2,027)	(19.2%)
NONMONETARY INT'L & REGIONAL ORG'S	**44,110**	**(1,082)**	**31,784**	**(38)**	**(27.9%)**
TOTAL ALL COUNTRIES*	**$1,020,533**	**$492**	**$956,337**	**$13,609**	**(6.3%)**

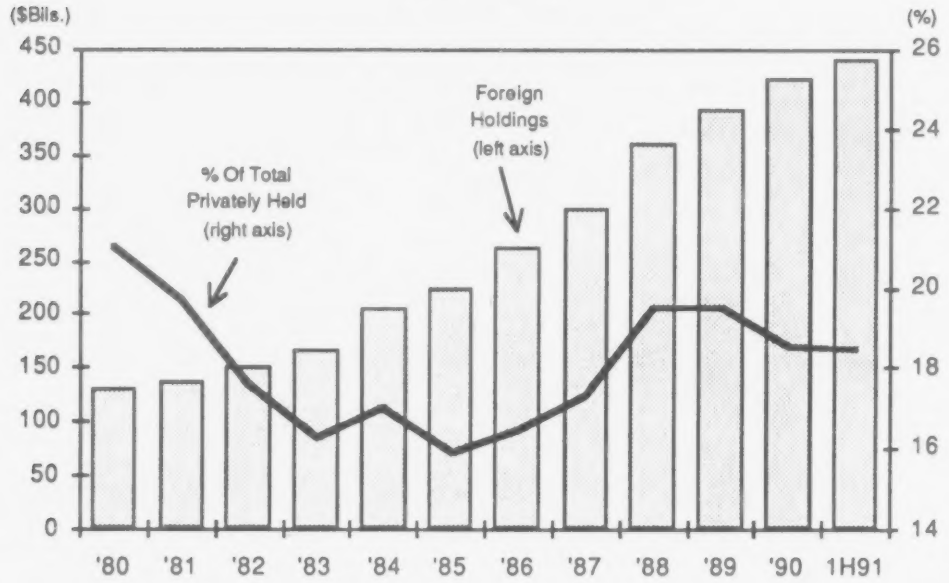
Source: U.S. Treasury
* Activity incorporates revised data

The second-quarter foreign inflow to the U.S. Treasury market was a welcome $13.6 billion dollars; official institutions sold off $1.1 billion, while private investors acquired near $16.3 billion. However, there was less here than meets the eye. Interest among private investors was not widespread: Spain (near $1.7 billion), Mexico (almost $1.3 billion), Canada ($793 million) and the U.K. ($708 million) were the largest players. Otherwise, the two areas of the world on which the U.S. depends for capital -- Asia and Europe -- were, on the whole, net sellers. Oddly, it was money from Latin America and the Caribbean which supplied the punch. Bermuda's second-quarter takedown was near $5.9 billion, while investors from the Netherlands Antilles acquired a whopping $7.8 billion.

Total foreign net purchases in 1H91 came to slightly over $14.1 billion. At an annualized rate, U.S. Treasury purchases by foreign investors will be above last year's $19.7 billion, but well below the peak years of 1988 and 1989, when acquisitions

totalled $48.8 billion and $54.2 billion, respectively. The reduction in interest in U.S. Treasuries is seen by the decline in the rate of growth in foreign holdings, which is depicted in the graph below. Interestingly, the reduced purchases of U.S. Treasuries by foreign investors has been off-set by a sharp increase in Treasury purchases by U.S. banks, perhaps serving to keep interest rates at lower levels.

Foreign Holdings Of U.S. Public Debt



One other interesting point to note is the position taken by official institutions, who've made net divestitures of Treasuries during 1H91 of almost $4.9 billion. This current pace could represent a significant departure from the pattern of the post-floating exchange rate era, during which central banks made net acquisitions of U.S. Treasuries. The last time net sales were made was in 1974, totalling $640 million. Net selling in 1H91 represented a concerted attempt by central banks to blunt the surprise rally in the dollar. Indeed, except for the U.K., the total reserves (minus gold) held by each of the G-7 countries as of mid-year 1991 fell from their year-end 1990 position.

U.S. Acquisitions Of Overseas Securities - U.S. Investors Load Up

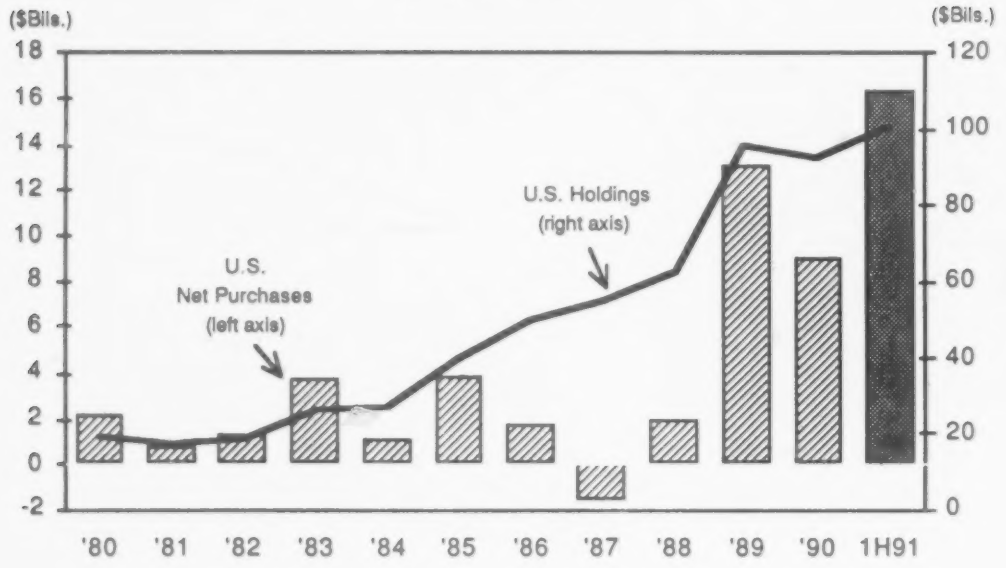
GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FIRST QUARTER 1991		*SECOND QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q91-1Q91*
EUROPE	**$36,958**	**$2,332**	**$36,729**	**$5,015**	**(0.6%)**
EUROPEAN COMMUNITY	*$33,269*	*$1,761*	*$35,559*	*$4,805*	*6.9%*
BELGIUM/LUXEMBOURG	471	(35)	401	(9)	(14.9%)
DENMARK	132	30	144	24	9.1%
FRANCE	2,618	106	3,015	695	15.2%
GERMANY	3,203	645	2,225	505	(30.5%)
GREECE	8	2	19	15	137.5%
IRELAND	52	(30)	119	41	128.8%
ITALY	1,676	252	658	100	(60.7%)
NETHERLANDS	1,975	(187)	2,094	588	6.0%
PORTUGAL	10	0	9	5	(10.0%)
SPAIN	1,250	128	1,005	139	(19.6%)
UNITED KINGDOM	21,874	850	23,498	2,680	7.4%
SWITZERLAND	2,456	290	2,372	22	(3.4%)
CANADA	**2,709**	**(385)**	**3,412**	**(218)**	**26.0%**
LATIN AMERICA & CARIBBEAN	**2,417**	**(241)**	**4,726**	**1,556**	**95.5%**
MEXICO	532	146	2,603	1,595	389.3%
ASIA	**18,853**	**5,275**	**15,561**	**2,845**	**(17.5%)**
JAPAN	15,996	5,230	11,795	2,613	(26.3%)
OTHER	**1,721**	**(95)**	**1,376**	**394**	**(20.0%)**
TOTAL ALL COUNTRIES*	**$62,658**	**$6,886**	**$62,335**	**$9,437**	**(0.5%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Perhaps the most stunning story in 1991 so far is U.S. investor purchases of foreign equities. No matter which way you slice it, the first half of 1991 has been one for the records. First-half acquisitions stand at $16.3 billion, more than $3 billion above 1989's *full-year record* of $13.1 billion. Moreover, 2Q91 net purchases alone totalled $9.4 billion, easily a quarterly record. Interestingly, 1H91's acquisitions were not accompanied by a surge in volume. This indicates that, at least in the first half, the main concern of the U.S. investor was to accumulate foreign equities, not buy and trade.

U.S. Net Purchases Of Foreign Equities



All the more impressive is that U.S. foreign equity purchases have occurred despite a strong showing in the U.S. equity markets. Given the admirable performance of the U.S. stock market in 1Q91, up 14.1%, and 12.6% for the first half, it is a little hard to understand why U.S. investors acquired unprecedented levels of (as measured by the *FT-Actuaries World Indices*) foreign equities. The explanation may lie on both economic and investment strategy grounds. First, net flows into the Mexican market totalled $1.6 billion, well over last year's total acquisitions of $909 million. This "spike" in net activity is a result of the May 1991 privatization of the Mexican telephone company, Telefonos de Mexico. The U.S. tranche of this deal totalled near $1.2 billion (44 million ADRs priced at $27.25). In addition, U.S. investors continued to look for investment opportunities in the EC, and further increased their holdings of Japanese equities.

The economic backdrop for U.S. activity overseas in 2Q91 was a declining interest rate environment, rising equity prices, and a general impression that a global economic upturn was not too far out on the horizon. The surge in U.S. foreign investment in 1991 was also a function of the heavy beating taken by stock markets in 1990 which left many European countries below their previous highs. For example, Germany and France were down over 20% while Japan plunged over 40%; presumably, this resulted in some bottom fishing by U.S. and other investors. One might make the case that U.S. investors are well positioned for any global equity market rally.

Performance Of Selected Equity Markets, 1H91

	Local Currency	*U.S. $*
Mexico	72.4%	68.8%
Sweden	36.3	17.0
Denmark	23.4	2.1
Spain	23.1	3.5
Switzerland	20.0	(1.7)
Netherlands	18.8	(1.9)
Ireland	16.1	(3.7)
Belgium	14.3	(0.5)
France	14.0	(5.6)
Italy	13.1	(5.4)
Germany	12.8	(7.1)
U.S.	**12.6**	**12.6**
U.K.	12.5	(5.6)
Canada	4.8	6.5
Japan	4.6	2.9

Source: *FT-Actuaries World Indices*

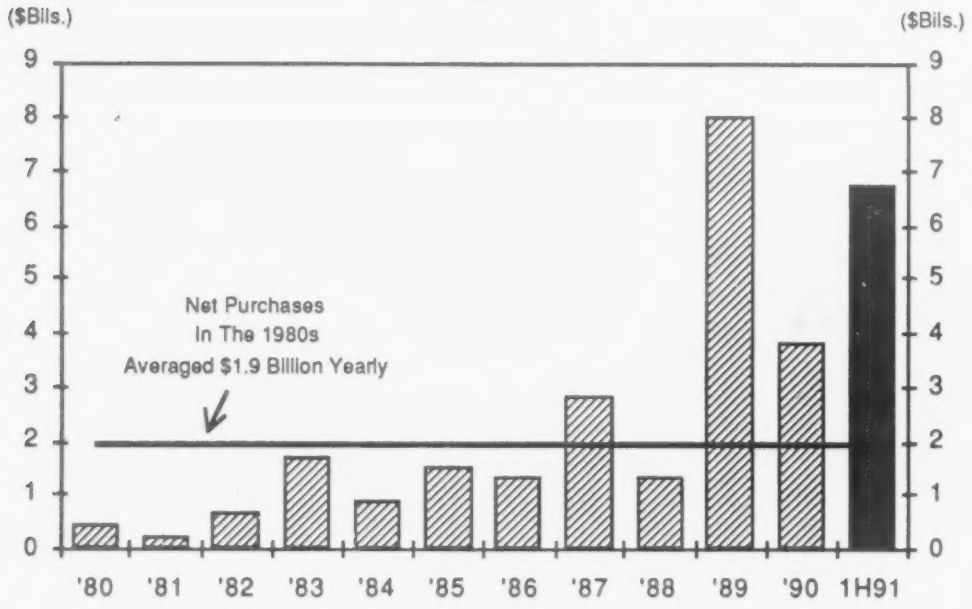
As shown in the table above, during 1H91 equity prices in Europe performed better, in local terms, than U.S. equities. While dollar adjusted returns were disappointing, the long-run investment strategy taken by U.S. investors suggest that not only do U.S. investors expect good future performance, but they are also betting that the sharp rally in the U.S. dollar may have seen its best days. So, expect for Belgium/Luxembourg, U.S. investors made net purchases in all other EC member states. The total for 2Q91 was almost $5 billion; 1H91 stands at over $7.3 billion.

Substantial acquisitions of U.K. equities totalling $2.7 billion were spurred on by several cuts in the U.K. lending rate made in the 1H91, from 14% to 11.5%. Despite news that the U.K. economy was deep in recession and March 1991's unemployment rise was the largest on record, U.S. investors looked to get in on the ground floor of a U.K. economic recovery.

In general, U.S. investment in EC equities has been at minimal levels, averaging net purchases of just under $2 billion per year in the 1980's. Only since 1989 have levels increased enough to be called substantial. On the back of a 24% increase in European equity prices, U.S. acquisitions peaked in 1989 at over $8 billion. While equity prices in 1990 twisted and turned, finally posting a 18.7% (local currency) decline, U.S. investors still acquired near $3.8 billion of European equities. Net acquisitions in 1991 indicate the increasing commitment U.S. investors are making towards EC, and to diversifying their portfolios. A recent survey by *Broadgate*

Consultants, Inc. noted that American fund managers consider continental Europe as the most attractive investment market, with 70% responding that prospects were excellent or good.

U.S. Net Purchases Of EC Equities



While half the first quarter's eye popping $5.2 billion, U.S. investment in Japan in 2Q91 was still a significant $2.6 billion. U.S. investment in Japanese equities for the 1H91 is nearly $8.0 billion, or nearly half of all U.S. *foreign* net equity purchases during this time span. In stark contrast, and as noted in our last *FAR*, U.S. investors made net sales of $4.2 billion for the decade of the 1980s. Entering the 1990s, U.S. investors were significantly under-weighted in Japanese equities. The 40% decline in the Tokyo market in 1990 created an opportunity for U.S. investors to increase their portfolio allocation to Japanese equities. The strategy by U.S. investors to move in after a 40% market decline may be a function of a longer-term approach being taken by U.S. fund managers in buying foreign equities and their need to diversify. Nearly three-quarters of U.S. money managers polled (*Broadgate Consultants, Inc.*) said that long-term capital gain was their primary reason for investing in foreign equities. About 60% said the same about diversification. This foray into Japanese equities is not just a U.S. phenomena. A *Smith New Court-Gallup Poll* of institutional money managers showed that 63% (the highest figure recorded since the survey began last year) of those interviewed in the U.K. were preparing to increase their holdings of Japanese equities.

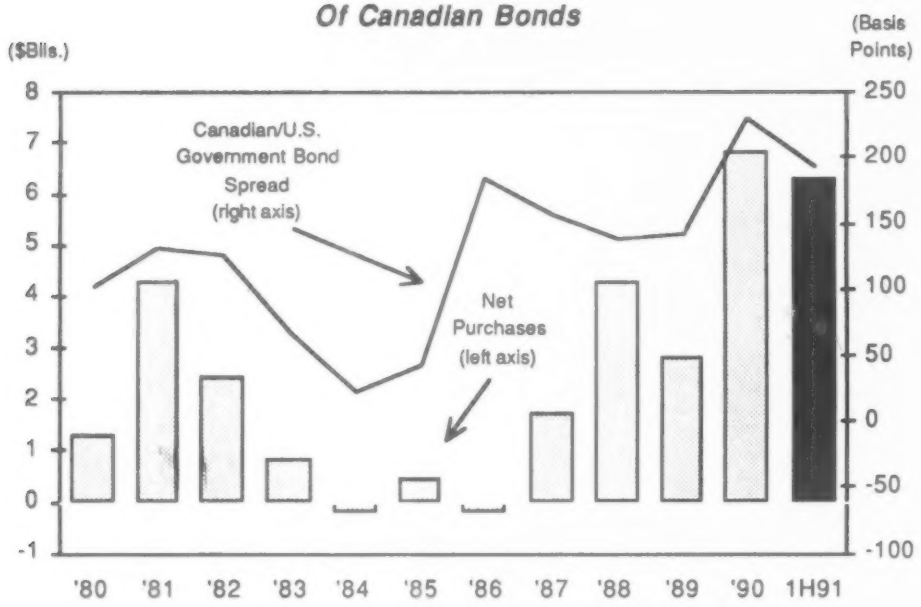
GROSS TRANSACTIONS IN AND NET PURCHASES OF
FOREIGN BONDS BY U.S. INVESTORS
($Mils.)

	FIRST QUARTER 1991		SECOND QUARTER 1991		% CHANGE
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	IN GA 2Q91-1Q91
EUROPE	$135,838	$714	$62,447	($427)	(54.0%)
EUROPEAN COMMUNITY	$127,847	$587	$60,096	$148	(53.0%)
BELGIUM/LUXEMBOURG	3,927	173	1,743	(211)	(55.6%)
DENMARK	3,372	(174)	402	10	(88.1%)
FRANCE	11,272	1,538	1,935	247	(82.8%)
GERMANY	12,230	(1,918)	2,307	(369)	(81.1%)
GREECE	48	(26)	8	(6)	(83.3%)
IRELAND	398	(16)	322	178	(19.1%)
ITALY	5,295	283	1,106	(72)	(79.1%)
NETHERLANDS	3,873	453	1,972	1,176	(49.1%)
PORTUGAL	47	(41)	10	2	(78.7%)
SPAIN	1,991	197	1,029	(59)	(48.3%)
UNITED KINGDOM	85,394	118	48,075	(655)	(43.7%)
SWITZERLAND	2,773	(43)	1,187	(93)	(57.2%)
CANADA	20,001	1,753	26,516	4,536	32.6%
LATIN AMERICA & CARIBBEAN	11,995	(539)	7,974	454	(33.5%)
MEXICO	235	15	978	770	316.2%
ASIA	36,222	(170)	23,959	(533)	(33.9%)
JAPAN	28,028	650	17,153	(159)	(38.8%)
OTHER	8,055	1,351	3,430	(300)	(57.4%)
TOTAL ALL COUNTRIES*	$212,111	$3,109	$126,593	$4,195	(40.3%)

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

U.S. investors made net purchases of foreign bonds of $4.2 billion during 2Q91. As in the first quarter, acquisitions was focused on Canadian fixed-income products. Acquisitions for the year now total $6.3 billion and are rapidly approaching the record high of over $7 billion in 1990. With yields on U.S. bonds falling, U.S. investors moved into the higher yielding Canadian market. Indeed, by the end of June, Canadian governments not only showed yields above those offered in most other major bond markets, but also showed a 1H91 total return (U.S. dollar) of almost 8%.

U.S. Net Purchases
Of Canadian Bonds



In general, this is turning out to be a banner year for issuing debt by Canadian issuers, as the federal and provincial governments, as well as private issuers, have flooded the market with new offerings. While U.S. investors have been the most voracious purchasers, data from *Statistics Canada* shows the interest to be worldwide. This is of no small consequence to Canadian issuers in general, and the federal and provincial government in particular, which depend on foreign investors for their capital needs.

One of the more interesting features of U.S. interest in foreign bonds is the 40% decline in activity in 2Q91's trading compared to that of 1Q91. Activity levels more than halved in Europe, and plunged as much as 80% in countries such as France and Germany. In all fairness, though, it should be noted that the activity levels seen in 1Q91 (and 4Q90 for that matter) averaged $211.1 billion, well above historical levels. Activity in 2Q91, at $126.6 billion, was more in-line with levels prior to 4Q90. For example, transactions per quarter averaged $111.1 billion and $118.6 billion in 1988 and 1989, respectively. Activity levels may have jumped in these two quarters as U.S. investors, searching for higher yields, dealt with a surprise rally in the dollar and the uncertainties posed by the Gulf War.

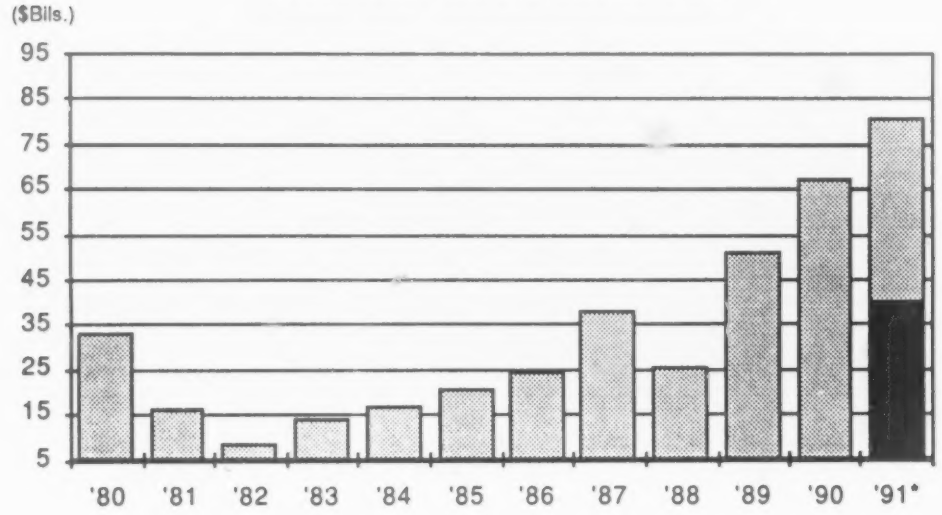
1H91 Total Rates Of Return For Selected Government Bond Markets

	U.S. $	*Local Currency*
A$	8.41	9.15
C$	7.98	6.33
U.S.$	3.48	3.48
¥	1.23	2.76
£	(9.74)	7.46
Ffr	(10.47)	8.17
DM	(12.50)	6.16
Dfl	(12.56)	5.85

Source: Salomon Brothers Inc

Finally, despite the troubles in the Italian economy, several market developments may increase U.S. participation in this market. First, it has been suggested that the Italian Finance Ministry consider abolition of the withholding tax on foreign investors. Secondly, futures on Italian bonds have now been introduced on the LIFFE and MATIF exchanges affording U.S. investors a way to hedge risk.

U.S. Acquisitions Of Foreign Direct And Portfolio Investments



*Annualized; 1H91 acquisitions noted by dark shading

On a broader scale, U.S. acquisitions of foreign assets continues at a relatively high level. In fact, at an annualized rate, U.S. acquisitions of foreign assets will total near $80 billion, well above the previous high in 1990 of $67.4 billion. Moreover, U.S. acquisitions have increased every year (except the post-crash year of 1988) since 1982. The pace of acquisitions places the U.S. as one of the world's major international investors once again. Just a few years ago, the halls of Congress were filled with rhetoric about foreign takeover of U.S. assets. Indeed, given the problems of the 1980's largest capital exporter, Japan, the U.S. may find itself the leading capital exporter. Now that's food for thought!

So what does this all mean? After all, foreign investors played a major role in financing U.S. capital needs in the 1980s by generously investing their domestic savings in our market. But now, the massive flows we saw in the mid-to-late 1980s seem a distant memory and unlikely to return soon. At the same time, U.S. investors are sending record amounts of U.S. savings overseas. And, to complicate matters, U.S. capital needs are further strained by a banking crisis. When we combine this with a U.S. saving rate which is near historic lows, it is reasonable to be concerned about the prospects for future economic growth.

The U.S. precariously treads on the road to economic recovery. The question of who will finance the capital needed for expansion, is a practical one, and not just an academic one. Either we stimulate greater domestic savings or we encourage foreigners to invest in the U.S. It would seem that we have more choices with the first alternative.

David G. Strongin
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